Testimony of

STEVEN WEMPLE

Director of Retail and Regulatory Affairs for

Consolidated Edison Energy

On Behalf of the Edison Electric Institute and its

Alliance of Energy Suppliers and Supplemental Comments of Con Edison Energy

Before the Federal Energy Regulatory Commission

"Compensation for Generating Units Subject to

Local Market Power Mitigation in Bid-based Markets"

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Good morning, Chairman Wood, Commissioners and Staff. I am Steve Wemple, Director of Retail and Regulatory Affairs for Consolidated Edison Energy, which is a subsidiary of Consolidated Edison, Inc. Con Edison Energy and its affiliates, Con Edison Solutions and Con Edison Development, are active in the New York, New England and PJM markets, own over 1,500MWs of generation in New England and PJM, and supply approximately 1500 MWs of retail load in New York and New Jersey.

I am appearing before the Federal Energy Regulatory Commission ("Commission") today on behalf of the Edison Electric Institute, a trade association that represents the shareholder-owned electric utilities, and its affiliated Alliance of Energy Suppliers, a division of EEI that specifically represents unbundled, bundled and independent power suppliers (together "EEI"), and Consolidated Edison Energy ("Con Ed").

First, I would like to commend the Commission for accepting the recommendation of EEI, PJM, and other parties to convene this technical conference to address issues surrounding compensation for must-run generators in organized markets.

The first part of my remarks address EEI's positions on this topic, with which Con Ed Energy fully agrees. Before concluding, I will share Con Ed Energy's perspective based on our own experiences owning and operating peaking units in New England and PJM, and hedging retail load positions in New York and New Jersey.

EEI believes that generators must be adequately compensated where required to provide the reliability services necessary to support the electric system. In fact, the Commission has an obligation to adopt rates that are just and reasonable for consumers and generators. Consistent under-recovery of investment dollars, which has been occurring in the New England and PJM markets, will naturally lead to reliability problems as owners are forced to defer maintenance on or retire existing generating units needed for reliability, and new infrastructure investments fail to materialize.

EEI is concerned that the need for a Reliability Must Run ("RMR") contract is indicative of a failure in the design of the local market to provide adequate compensation for units needed for reliability. If the existing market rules are not providing adequate compensation for specific units needed for reliability, the ISO/RTO should determine the need for design changes that can provide adequate compensation and work with stakeholders to effectuate the necessary changes. EEI's preference is for market-based solutions to determine appropriate compensation for all units. In the absence of market solutions, EEI believes that out-of-market intervention is appropriate to ensure reliability and that such intervention must be structured to provide adequate compensation, and to

the extent possible, to emulate a competitive market-based solution. These decisions should be set forth in rules, and procedures must be incorporated in tariffs filed with the Commission. Also, the market needs a level of regulatory certainty that can only be achieved by the RTO/ISO establishing and publishing a clear objective standard on what constitutes market power and criteria by which a determination to mitigate would result.

Because many of the units considered for RMR treatment are located in areas where there is limited transmission and/or generating capacity, there are concerns that such units could exert market power absent some form of mitigation. In situations where there is a demonstrated concern about market power, monitoring, mitigation, or other measures may need to be considered to restrain the exercise of market power. However, mitigation measures have to be structured in such a way that they do not discourage the long-term investment signals necessary to attract and retain generation and demand side resources and must not deprive existing owners of an opportunity to recover all Long Run Marginal Costs, inclusive of variable and fixed costs.

For example, mitigation measures that limit the marginal unit's bids to variable production costs will deny that unit any opportunity to recover fixed costs from the energy market. In addition, if a region does not have sufficient supplies to meet its load and reserve requirements, then market rules and mitigation measures, in particular, should not set prices so artificially low, even if slightly above the production cost of the units, as to suppress the natural price signal that supplies are scarce. Ultimately, EEI believes that a market that is able to attract and retain necessary resources (local or delivered generation and demand response), without the use of subsidies, is in the consumers' best interest because it provides the long-term solutions to relieve market

power concerns, maintains reliability, produces just and reasonable prices, and enhances quality of service.

The design of RMR and mitigation mechanisms needs to allow for variations, including regional ones, due to differences in resource mix, cost structures and operating requirements. The costs associated with RMR mechanisms should be borne locally and preferably conveyed through well-designed existing mechanisms such as capacity and/or energy market pricing. This allows local loads to either react to the price (and the local reliability need) with demand response measures and/or be able to hedge their costs through purchases of capacity and/or energy. With respect to capacity markets, EEI believes that there are a variety of mechanisms that will allow RMR generation to obtain adequate compensation (e.g. properly structured regional capacity markets with deliverability requirements and properly structured locational capacity markets).

Finally, EEI believes the Market Monitor needs to be truly independent of the markets that they monitor, and should have a screening, but not determinative, role in establishing the need for mitigating RMR units. The ISO/RTOs, not the Market Monitor, should decide whether and how to implement RMR mitigation. EEI believes mitigation rules and implementation procedures need to be clearly articulated in tariffs filed with and approved and accepted by the Commission. As illustrated in our testimony, EEI fully supports the Commission's goal of fostering the development of a vibrant, competitive wholesale electric market. EEI would like the opportunity to file supplemental comments following the conference and provide a list of principles for RMR contracts.

Con Edison Energy

I would now like to take a moment to share experiences Con Ed Energy has encountered as an owner and operator of peaking units in New England and PJM and hedging retail load positions in New York and New Jersey. Con Ed believes that the problems facing RMR units are symptomatic of issues facing the overall electricity markets throughout the country and in PJM and New England in particular. Specifically, the markets have not been and are not projected to provide sufficient revenues to pay the carrying cost of a new merchant plant. While some parties may dismiss this as the natural result of excess generation, Con Edison Energy disagrees and believes that the issue of revenue adequacy needs to be addressed.

Last summer I performed an analysis of the prior PJM State of the Market Reports and presented the results to PJM and included them in our October 30th comments on proposed PJM mitigation plan. My analysis demonstrates that the net revenues for peaking units were overstated in each of the Reports since 1999, which makes the revenue shortfall worse than has been reported. My analysis indicates that from 1999 through 2003, peaking units have only recovered 70% of their required revenues. 2003 was even worse and the forward curves indicate that 2004 and 2005 will only provide 30% of requirements. This means existing units can't afford normal maintenance and no new merchant plants will be built without significant market reforms. Although consumers are currently burdened by high electricity costs related to high gas and oil prices, market reforms are needed to both adequately compensate and retain existing units and attract the new resources necessary to meet the projected 2007 need date in PJM.

In PJM, the discussion of RMR units has focused on peaking units that either don't run much or are mitigated to variable cost + 10% when they do operate. In either case, these units are unable to obtain much needed energy revenues, are only getting paltry capacity revenues and receive no compensation for the 10-minute non-spinning and 30-minute reserves they provide.

Con Ed believes PJM needs to implement market reforms to

1. Establish markets that compensate units providing 10-minute non-spin and 30-minute reserves and, if there are local requirements, local markets for those services too. [It's worth noting that New England, which adopted the PJM energy platform and its absence of full reserve markets, was able to implement a Forward Reserve Market this year.]
2. Establish scarcity pricing rules so that when PJM is short on energy or reserves and calls on block loaded units or makes emergency energy purchases, energy prices aren't set artificially low by a steam unit that has to reduce its output.
3. Reform the capacity markets to value resources in excess of minimum requirements and avoid the market clearing at or near zero when there's a small surplus and, if there are local needs that aren't being met, consider adopting a local capacity market.

I'd like to also share with you Con Ed's perspective hedging our retail load obligations. From an LSE perspective, we believe it is essential for RMR funding mechanisms to work through existing energy and/or capacity market mechanisms so that the costs for these services can be hedged. Out of market payments to RMR units that

create unpredictable uplift costs are harmful to retail markets as they create uncontrollable financial risks for LSEs.

Con Edison Energy believes that the energy pricing in the NYC load pockets and the pricing of local capacity in NYC and Long Island provide a workable solution to local reliability needs by generating price signals for the locational value of capacity and energy to all resources including demand response, transmission, and generation. In addition, by incorporating the cost of the local reliability needs into local capacity and energy markets, LSEs serving load in New York City and Long Island are able to hedge these costs through local capacity and energy purchases.

Thank you and I welcome any questions at the respective time.